April 15, 2013

The Honorable Dave Camp
Chairman
Committee on Ways and Means
United States House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

The Honorable Sander Levin
Ranking Member
Committee on Ways and Means
United States House of Representatives
1106 Longworth House Office Building
Washington, DC 20515

The Honorable Kenny Marchant
Debt, Equity and Capital Working Group
Committee on Ways and Means
United States House of Representatives
1110 Longworth House Office Building
Washington, DC 20515

The Honorable Jim McDermott
Debt, Equity and Capital Working Group
Committee on Ways and Means
United States House of Representatives
1035 Longworth House Office Building
Washington, DC 20515

RE: Interest is an Ordinary and Necessary Business Expense and Should Remain Fully Deductible.

Dear Chairman Camp, Ranking Member Levin, Congressman Marchant, and Congressman McDermott:

The organizations listed below are submitting this letter in response to the Ways and Means Committee's invitation to submit comments on tax policy as the Committee and its Working Groups weigh options for comprehensive tax reform. We applaud the committee for its readiness to examine the nation's tax code to encourage innovative entrepreneurship, investment in job creation, and capital formation. As the committee begins to discuss appropriate reforms to the tax code, we reinforce the necessity of preserving the full deductibility of debt interest.

Corporate debt is an essential tool used by businesses, small and large alike, to grow and finance operations. According to the Small Business Administration, four in five small businesses use debt in their capital structure. A recent study by Drs. Rebel Cole at DePaul University and Tatyana Sokolyk of Brock University shows that 75 percent of start-ups finance their activities with some type of debt with 44 percent using business debt and 24 percent using trade debt.[1] Debt is a fundamental part of a typical company's capital structure and is often used to finance day-to-day operations and fundamental business activities like meeting payroll, buying raw materials, making capital expenditures, building new facilities, and financing asset acquisitions that allow manufacturing and industrial firms to expand as the economy improves. All these expenses are incurred in the ordinary course of trade or business and the interest on these loans is therefore tax deductible.

The tax code is currently symmetric with respect to debt. Generally, each dollar of interest deducted from the borrower's income is a dollar included in the creditor's taxable income. Debt also creates an environment of fiscal discipline as investors carefully examine business plans prior to investing and maintain a close watch on the progress and growth of their investments. Debt also provides investors with greater security than equity because it provides payment seniority and is often collateralized by physical or intangible assets.

[1] Cole, Rebel A., and Tatyana Sokolyk. "How Do Start-Up Firms Finance Their Assets? Evidence from the Kauffman Firm Surveys." (March 1 2012) SSRN. http://sites.kauffman.org/efic/resources/How-Do-Start-Up-Firms-Finance-Their-Assets.pdf

Limiting interest deductibility would penalize early stage and innovative companies that rely on external financing to expand or create jobs. Such a policy change would mean that the tax code, and not investors, would be picking which companies are more likely to receive financing and which are more likely to be disregarded. For example, promising companies that are investing in the technologies of tomorrow would be disproportionately and negatively impacted because they rely on debt financing to fund investments.

The ability to access debt as a strategic method for acquiring capital creates options for business owners and investors looking to finance a new business, or engage in a capital expansion. Businesses owners are able to raise capital and finance growth without having to relinquish control or decision making authority in their companies. The capacity to maintain ownership and decision making ability is particularly important in the cases of start-up capital where entrepreneurs often have a defined vision and may not want to dilute their decision-making authority by being forced to issue stock, should equity finance even be available, just to raise capital. It is vital that this committee reinforces its policies to preserve options, including full deductibility of interest on debt, to business owners and allow them to decide what is best for the companies.

Furthermore, limiting interest deductibility will significantly increase the marginal effective tax rate on new investment and could stifle growth in the United States, undermining a stated goal of corporate tax reform. Changing the traditional rules of capital formation by limiting or eliminating the ability to deduct the interest on corporate debt would simply make the United States a less attractive place for business and job creation. The higher cost of investment from limiting interest deductibility, even when coupled with a revenue neutral reduction in corporate tax rates, would hamper U.S. investment.

Last year, Drs. Robert Carroll and Thomas Neubig from Ernst & Young LLP issued a report that finds that an across-the-board limitation on the deductibility of corporate interest would increase companies' cost of investment by significantly more than the reduction in the cost of investment achieved through a corresponding reduction in corporate income tax rates. To quote the Ernst & Young Report, "Rather than making the United States a more attractive place to invest by lowering the marginal effective tax rates for new investment, a 1.5 percentage point reduction in the corporate income tax rate financed by limiting the deductibility of interest expenses would increase the marginal effective tax rate on new corporate investment from 31.0 percent to 33.1 percent – a 6.7 percent increase in the marginal effective tax rate."[2]

We believe that the committee's effort to create a more competitive tax code should benefit the United States. Tax reform, however, should not come at the expense of eliminating fundamental tax principles that are essential to the conduct of business. Limiting the ability to deduct ordinary business expenses, or changing the longstanding definition of those expenses, will have a negative impact of capital growth. We would encourage the committee, in any proposed tax legislation, to maintain the full deductibility of business interest debt as it exists under current law.

Sincerely,

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[2] Carroll, Robert, and Thomas Neubig. Business Tax Reform and the Tax Treatment of Debt: Revenue-Neutral Rate Reduction Financed by an Across-the-Board Interest Deduction Limit Would Deter Investment. Ernst & Young, May 2012.

Equipment Leasing and Finance Association

Hilton Worldwide

International Council of Shopping Centers

International Franchise Association

National Apartment Association

National Multi Housing Council

National Leased Housing Association

Real Estate Roundtable

Rockwell Collins

Small Business and Entrepreneurship Council

Small Business Investor Alliance

Travel Technology Association